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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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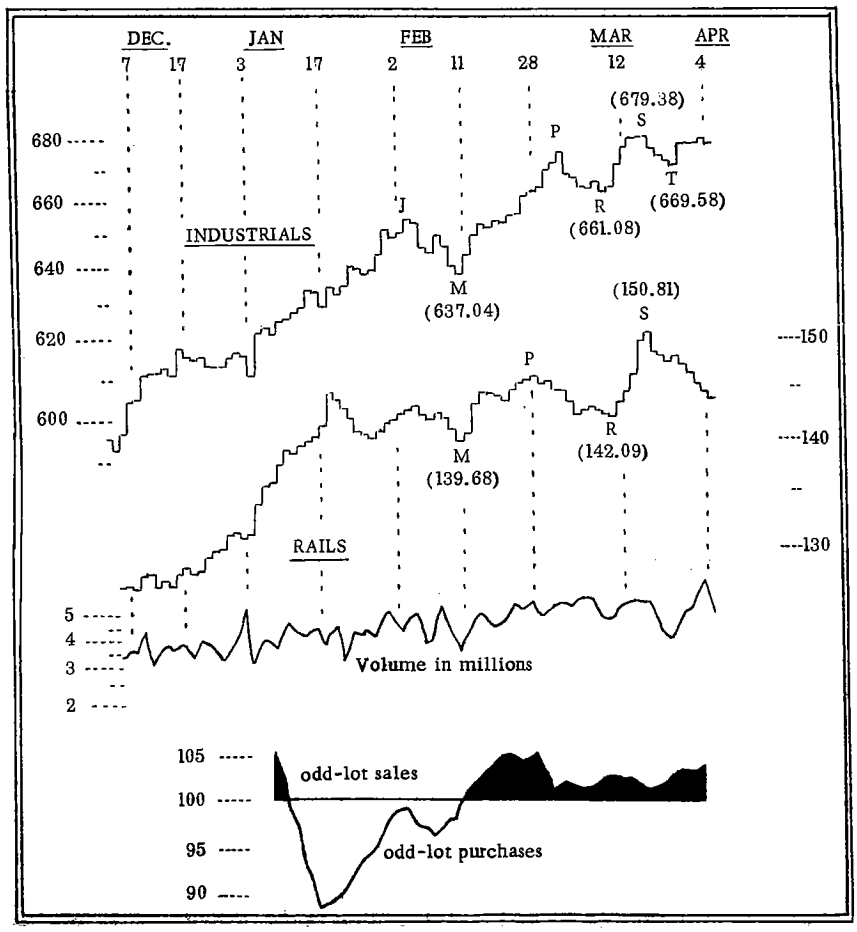
PRICE MOVEMENTS Having given their half of a bull signal, Rails rose to a high at S (150.81), then retreated steadily in the face of a barrage of unfavorable rail earnings statements. The disheartening erosion in the carrier index has prompted many anxious letters from readers who wonder whether the March 22 Rail confirmation could have been "a false one". As far as Dow's Theory is concerned, there is no law which states that an upward penetration must immediately be followed by higher prices (although this has usually been the case). The two Averages have now confirmed a primary uptrend, and as long as one or both Averages hold above significant preceding levels, the secondary (together with the primary) trend must be considered as remaining bullish.

For the convenience of readers, preceding decline points have been marked on the chart. Under Dow Theory the movements of the Industrial and Rail Averages are always to be considered together. A penetration of one Average unconfirmed by the other often portends a reversal, and if Rails continue to show weakness all eyes will be on Industrials. The first downside checkpoint on Industrials is at T (669.58), the second is at R (661.08). A persistent refusal by Industrials to penetrate one or both of these levels in the face of continuing Rail weakness could have bullish implications.

First signs of possible trouble would be an Industrial penetration of T, and then a joint penetration (both Averages) of R with an accompanying increase in volume. Volume indications over the last few months have been both accurate and helpful. An approach to preceding lows (such as R) on sharply reduced volume should be taken bullishly. Conversely, a joint penetration of preceding lows on increasing volume would be a danger signal worth heeding. As of this writing, all declines have been accompanied by an almost dramatic reduction in volume of trading.

The Rail divergence (Rails declining as Industrials advance) together with the recent spectacular volume is hardly calculated to calm the nerves of market students. Such action has often "tipped" important turning points, but it is worth noting that a great deal of divergence has occurred since the Rails touched their first peak at J (January 18). Up to now, each period of divergence has ended with Rails finally getting "in gear" with Industrials on the upside. But those happy performances (as veteran traders well know) are no infallible guide to the future.



Anxieties are heightened by the fact that Industrials have now entered the 670-80 area for the third time since August, 1959. The "triple top" formation of 1956-57 (see Letter 136) is still fresh in the minds of many investors, and doubtless they will not feel at ease until the 685.47 mark is hurdled by the senior Average. However, there are some important technical considerations which separate the 1957 period from the present one. During 1957 odd-lotters bought in increasing quantities from May through the end of the year. In the current period odd-lot transactions have been on the cautious side since November, 1960. The advance-decline ratio turned down in March, 1957, and it continued down until November, 1957. During the current rise, the advance-decline ratio has lead

the Averages throughout the entire rise. The biggest minus factor in the current market is the short interest ratio. In July, 1957 it was 1.2; it is now .72.

THE RECORD The present advance began for Industrials on October 25, 1960 at 566.05. As of the recent high (S--679.38), Industrials had gained a total of 113 points (without a correction) in a period of a little under five months. While not a record, this is a performance which has been surpassed on only five occasions in the history of the Averages. In order to place the advance in historical perspective, I have listed the five great advances below.

Advance began	Advance ended	Starting pt. of advance	Advance ended	Points advanced
6/18/28	11/28/28	201.96	295.62	93.66
5/27/29	9/3/29	293.42	381.17	87.75
11/13/29	4/17/30	198.69	294.07	95.38
9/14/53	4/5/56	255.49	521.05	265.56
10/22/57	8/3/59	419.79	678.10	258.31

Of these five upward swings it should be noted that four were bull market advances, but that the 1929-30 rise was an extremely deceptive movement in a continuing bear market. Whether or not the current advance will take its place among the first three swings listed above or whether it will eventually take its place with the last two nobody can know at this time. It is worth remembering, however, that regardless of the amount of points gained, advances which begin from high levels must be less impressive from the standpoint of percentages. If the current swing, which started from 566, were to add 250 points to the Industrial Average (taking it to 816) the percentage increase in Industrials would be 44% (against, for instance, the 1953-56 increase of 104%).

ODD-LOT SENTIMENT Letter 137 discussed the odd-lots and included a chart which depicted weekly totals of odd-lot purchases, sales and short sales. A much more sensitive method of portraying odd-lot or public sentiment is used by Mr. Garfield Drew of Boston. Each day total odd-lot sales (including short sales) are divided by odd-lot purchases, and the result is an odd-lot ratio. A ratio of 1.0 means that odd-lot purchases and sales are exactly equal, a ratio of over 1.0 means that odd-lot sales are running above purchases, and a ratio of below 1.0 means that odd-lot purchases are in excess of sales (for instance .70 means that 7 shares were sold for every 10 bought). Normally odd-lotters are optimistic, and a ratio of .90 might be considered a "normal ratio".

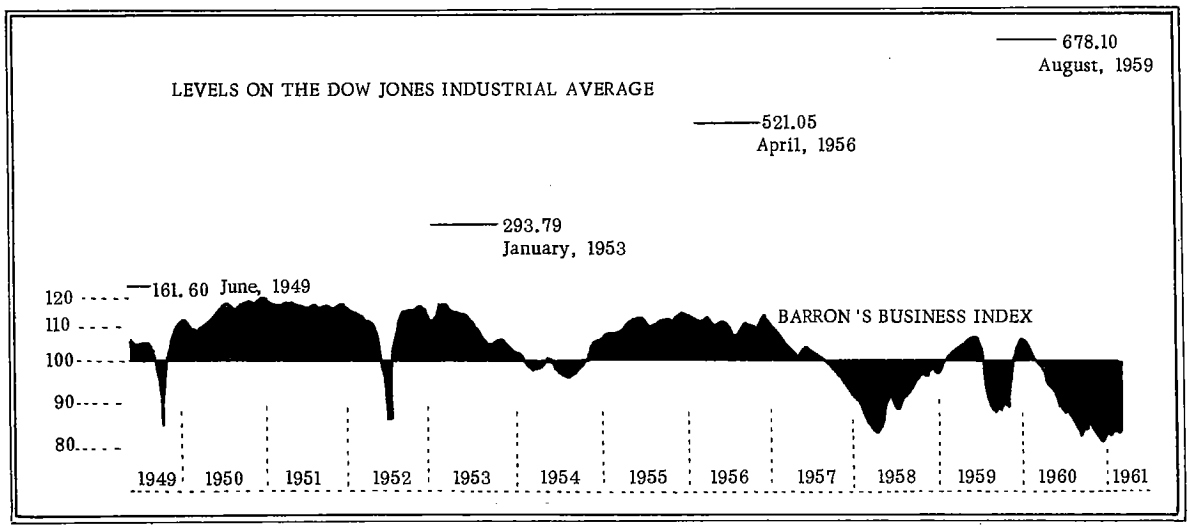
While the direction or trend of odd-lot sentiment is by all odds the most important factor, it is nevertheless unusual to witness consistent odd lot selling-balances. As stated in Letter 137, odd-lot selling has continued quite consistently since mid-November, 1960, and this must be considered an abnormal situation. Since the market has risen steadily in the fact of this odd-lot selling, the implication is that stronger hands have been buying and moving the market higher.

Page 1 of this Letter contains a chart which shows odd-lot ratios since January 6, 1961. The ratios are arranged (after Drew's method) in a ten-day moving average (this moving average merely "smooths" the action and makes it easier to spot trends). Ordinarily, during the first few weeks of January, there is a reinvestment of dividends, and this probably produced the early odd-lot buying balances (white area) on the chart. The chart also shows that odd-lot buying sentiment hit a high of 88 on January 16. From that point on, buying gradually decreased again, and on February 13 the moving average switched to actual selling on balance (solid black area).

Odd-lot selling hit a high of 104 on February 17, decreased slightly to 101 on March 7, then increased again. Throughout March there has been no real change in odd-lot sentiment, and although this week saw three days of very light odd-lot buying, odd-lotters switched to selling on April 5 (and the 10-day moving average rose to its highest selling balance since February - see chart).

BUSINESS AND THE MARKET Barron's Business Index is one of the nation's oldest gauges of economic activity. Its components include steel and coal production, petroleum and power output and rail carloadings. The Index is adjusted for seasonal influences and long-term growth and population trends. With the increasing importance of the service sector of the economy, it may be said that there now exists a great deal of activity which Barron's Index does not reflect. Nevertheless, the Index does deal with the capital goods and production segment of the economy, and this is the segment which (so far) has been responsible for business cycles.

The chart on page 3 shows the profile of Barron's Business Index since 1949, together with significant peak levels in the D-J Industrial Average. Note the strength in Barron's Index during the prosperous period of 1950-53 (the drop in 1952 was due to the steel strike). Note also, the shallow dip in the Index during the 1953-54 recession. During 1955-56 the Index again rose sharply as production of consumer and capital goods boomed again. In 1957-58 another recession arrived,



and Barron's Index touched a low of 81 in April, 1958. As in 1954, the economic recovery from the 1957-58 recession was rapid and almost violent. From the April, 1958 low, Barron's Index climbed steadily to 106.7 in early 1959. The nation's longest steel strike interrupted the upward progress of the Index in mid-1959, but following the steel strike the Index again rose to 106.6 (January, 1960).

During the 1959-60 bear market Barron's Index fell to 79.9, its lowest level since 1949. But what is perhaps just as significant is the sluggishness of the Index over the last three months. Whereas the Index reversed quickly to the upside in 1954 and 1958, the recent action of the Index presents a picture of "heaviness". The extreme low in Barron's Index was recorded in the week of December 5, 1960, at 79.9. The new bull market began one month earlier on September 29, and the real upward momentum in the market did not get underway until late December. But as of this week, Barron's Business Index provided a reading of only 81.2, a rather "tired" effort considering the market advance so far.

By rendering a bull signal, the Averages have said that business will improve over the foreseeable future. But just as it is fruitless to predict the possible length or height of a bull market, it is also impossible to predict the extent or duration of a period of economic expansion.

Over the last five months we have witnessed investor sentiment turn from pessimism to hopefulness (forgetting the odd-lot public which remained bearish). Predictions are now appearing with increasing frequency to the effect that an economic "boom" is in the offing (a "violent" boom, according to Fortune Magazine). My own opinion differs somewhat from most of the forecasts which are being heard today. I believe that the "boom" could be largely in the stock market rather than the economy. In fact I would not be surprised if, during the current period of business expansion, Barron's Index failed to reach 100.

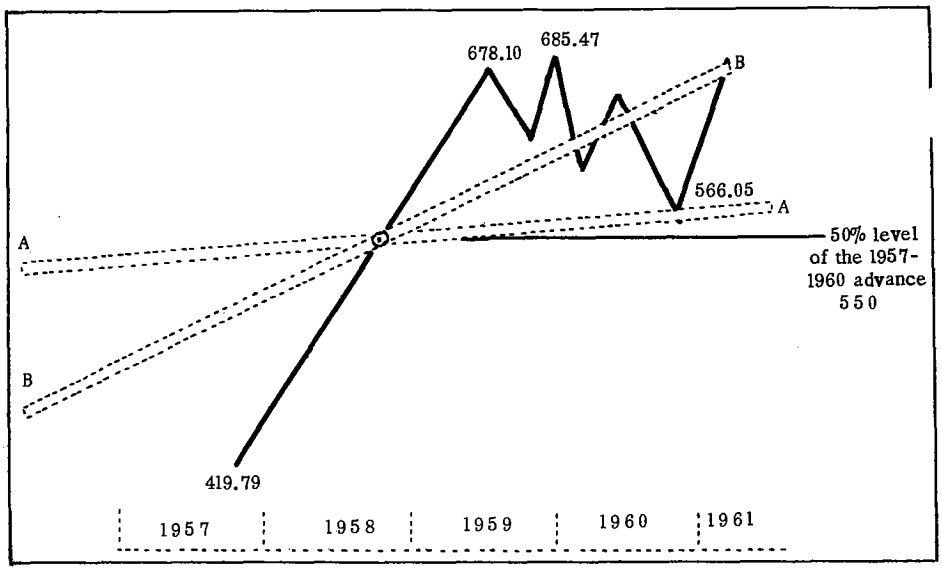
THE BALANCE (see chart page 4) Last year subscribers received a special study of Dow's 50% Principle. In that study I mentioned that Dow often likened market action to certain physical laws, and that he took particular note of what the market did at the halfway point of important swings.

In discussing Dow's 50% concept, I have found it useful to view the market as a giant scale or balance. The equilibrium or halfway point on the balance now stands at 550 on the D-J Industrial Average. This is the halfway point of the entire swing from 419.79 (October, 1957) to 685.47 (January, 1960). The balance concept is illustrated on the accompanying diagram.

In January, 1960, the beam of the balance was in the position marked B on the diagram (Industrials at 685.47). During the course of the bear market the beam tilted down towards equilibrium or towards the 550 level. But the Industrials stopped at 566.05 (position A on chart), and they refused by 16 points to violate the halfway point of the 1957-60 advance. Had the 550 level been violated, it is my opinion that the bear market would have been disastrous.

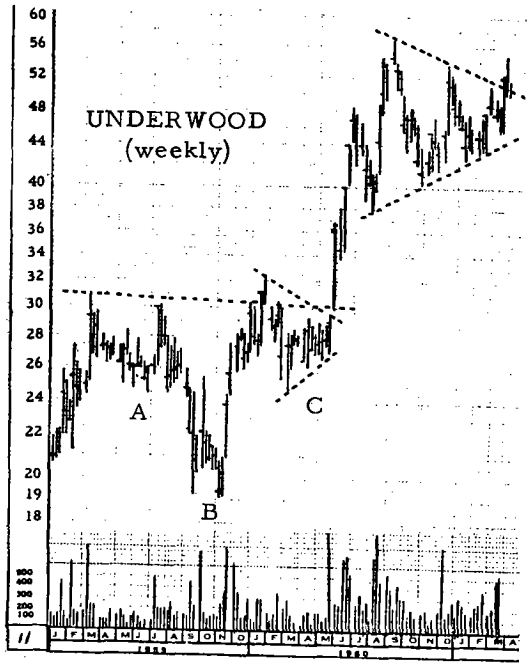
The persistent refusal to violate 550 meant, under Dow's 50% Principle, that the odds favored another upward swing of the beam (see Letter 130, January 16, 1961). The upward swing began

in October, 1960, and by March 22, 1961, the Industrial Average had again swung to position B (Industrials -- 679.32 on March 22, 1961).



At this writing, Industrials are still in the vicinity of the high (in the B position). If Industrials can better 685.47 the balance beam will have "broken free", and the upward force could be considerable. Conversely, if the beam swings down again we will be watching (1) the 620 level for the reasons outlined in Letter 136, and (2) the 550 level, which still remains as the critical center of equilibrium.

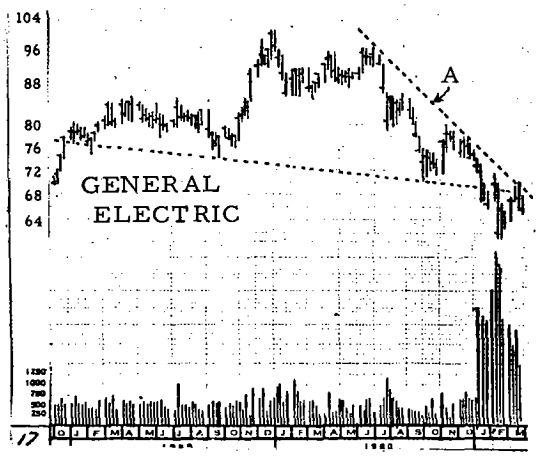
STOCKS Low yields and high volume hardly provide an ideal background for long-term investment buying. I continue to view the market as a "hunting ground" for speculators. Because of the weakness of the rails following the upward penetration of the 146.56 level, it might be instructive to examine the action of one of the speculative rail leaders -- N.Y. Central. The chart shows CN basing in December, 1960, then bettering its 30-week moving average in February, 1961. During the January to February period the short position in CN rose sharply from 6.5 to 15.4 thousand shares. Following the high of the move at 22, CN has backed down to the 19 area. The long-term (30-week) moving average now stands at 17 3/8, and this area should show very strong resistance to any downside movement.

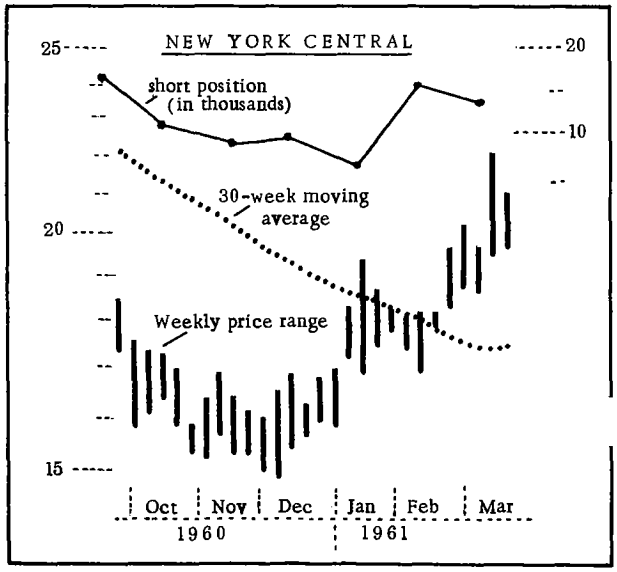


Letter 136 drew attention to the symmetrical triangle in Underwood and stated that the breakout or "buy point" would be 53. The action of UNX since then demonstrates some of the difficulties confronting the trader in a speculative market. The stock rushed to 54 7/8, dropped back within the triangle and touched a low of 49 1/2, and on April 5 rallied to 55 1/8.

Note the huge 1959-60 inverse "head-and-shoulders" formation in UNX (A-B-C). The right shoulder took the form of a triangle (C) and the force of the upward breakout was tremendous. It remains to be seen whether the upward force on the current breakout will match that of 1960.

General Electric's action has been most interesting. Having formed an immense head-and-shoulders pattern, the stock cracked its base at 68, but downside momentum was not forthcoming. Note the great expansion of volume at the lows. The fact that the stock has tended to hold on huge volume and is now moving sideways through its downward trendline (A) is a hopeful indication. Any advance above 70 could be the start of a substantial upward movement in G.E.





Charts of G.E. and UNX courtesy of Traders Research, P.O. Box 6185, Lambert Airport, Mo.